

use shall be deemed to occur in the year the dual consolidated loss is included in the computation of the taxable income of a consolidated group, unaffiliated dual resident corporation, or an unaffiliated domestic owner, as applicable, even if no tax benefit results from such inclusion in that year. See § 1.1503(d)-7(c) *Examples 2 through 4*.

[T.D. 9315, 72 FR 12914, Mar. 19, 2007]

§ 1.1503(d)-3 Foreign use.

(a) *Foreign use*—(1) *In general*. Except as provided in paragraph (c) of this section, a *foreign use* of a dual consolidated loss shall be deemed to occur when any portion of a deduction or loss taken into account in computing the dual consolidated loss is made available under the income tax laws of a foreign country to offset or reduce, directly or indirectly, any item that is recognized as income or gain under such laws and that is, or would be, considered under U.S. tax principles to be an item of—

(i) A foreign corporation as defined in section 7701(a)(3) and (a)(5); or

(ii) A direct or indirect owner of an interest in a hybrid entity, provided such interest is not a separate unit. See § 1.1503(d)-7(c) *Examples 5 through 10 and 37*.

(2) *Indirect use*—(i) *General rule*. Except to the extent provided in paragraph (a)(2)(ii) of this section, an item of deduction or loss shall be deemed to be made available indirectly if—

(A) One or more items are taken into account as deductions or losses for foreign tax purposes, but do not give rise to corresponding items of income or gain for U.S. tax purposes; and

(B) The item or items described in paragraph (a)(2)(i)(A) of this section have the effect of making an item of deduction or loss composing the dual consolidated loss available for a foreign use as described in paragraph (a)(1) of this section.

(ii) *Exception*. The general rule provided in paragraph (a)(2)(i) of this section shall not apply if the consolidated group, unaffiliated domestic owner, or unaffiliated dual resident corporation demonstrates, to the satisfaction of the Commissioner, that the item or items described in paragraph (a)(2)(i)(A) of

this section that gave rise to the indirect foreign use—

(A) Were not incurred, or taken into account, with a principal purpose of avoiding the provisions of section 1503(d). For purposes of this paragraph (a)(2)(ii), an item incurred or taken into account as interest for foreign tax purposes, but disregarded for U.S. tax purposes, shall be deemed to have been incurred, or taken into account, with a principal purpose of avoiding the provisions of section 1503(d). Similarly, for purposes of this paragraph (a)(2)(ii), an item incurred or taken into account as the result of an instrument that is treated as debt for foreign tax purposes and equity for U.S. tax purposes, shall be deemed to have been incurred, or taken into account, with a principal purpose of avoiding the provisions of section 1503(d); and

(B) Were incurred, or taken into account, in the ordinary course of the dual resident corporation's or separate unit's trade or business.

(iii) *Examples*. See § 1.1503(d)-7(c) *Examples 6 through 8*.

(3) *Deemed use*. See paragraph (e) of this section for a deemed foreign use pursuant to the mirror legislation rule.

(b) *Available for use*. A foreign use shall be deemed to occur in the year in which any portion of a deduction or loss taken into account in computing the dual consolidated loss is made available for an offset described in paragraph (a) of this section, regardless of whether it actually offsets or reduces any items of income or gain under the income tax laws of the foreign country in such year, and regardless of whether any of the items that may be so offset or reduced are regarded as income under U.S. tax principles.

(c) *Exceptions*—(1) *In general*. Paragraphs (c)(2) through (9) of this section provide exceptions to the general definition of foreign use set forth in paragraphs (a) and (b) of this section. These exceptions only apply to a foreign use that occurs solely as a result of the conditions or circumstances described therein, and do not apply if a foreign use occurs in any other case or by any other means. For example, the exception under paragraph (c)(4) of this section (regarding certain interests in

partnerships or grantor trusts) shall not apply where the item of deduction or loss is made available through a foreign consolidation regime (or similar method). In addition, these exceptions do not apply when attempting to demonstrate that no foreign use of a dual consolidated loss can occur in any other year by any means under § 1.1503(d)-6(c), (e)(2)(i), or (j)(2). But see § 1.1503(d)-6(e)(2)(ii), which takes into account the exception under paragraph (c)(7) of this section for purposes of rebutting certain asset transfers.

(2) *Election or merger required to enable foreign use.* Where the laws of a foreign country provide an election that would enable a foreign use, a foreign use shall be considered to occur only if the election is made. Similarly, where the laws of a foreign country would enable a foreign use through a sale, merger, or similar transaction, a foreign use shall be considered to occur only if the sale, merger, or similar transaction occurs.

(3) *Presumed use where no foreign country rule for determining use.* This paragraph (c)(3) applies if the losses or deductions composing the dual consolidated loss are made available under the laws of a foreign country both to offset income that would constitute a foreign use and to offset income that would not constitute a foreign use, and the laws of the foreign country do not provide applicable rules for determining which income is offset by the losses or deductions. In such a case, the losses or deductions shall be deemed to be made available to offset the income that does not constitute a foreign use, to the extent of such income, before being considered to be made available to offset the income that does constitute a foreign use. See § 1.1503(d)-7(c) *Example 11*.

(4) *Certain interests in partnerships or grantor trusts—(i) General rule.* Except to the extent provided in paragraph (c)(4)(iii) of this section, this paragraph (c)(4)(i) applies to a dual consolidated loss attributable to an interest in a hybrid entity partnership or a hybrid entity grantor trust, or to a separate unit owned indirectly through a partnership or grantor trust. In such a case, a foreign use will not be considered to occur if the foreign use is solely the result of another person's ownership of an inter-

est in the partnership or grantor trust, as applicable, and the allocation or carry forward of an item of deduction or loss composing such dual consolidated loss as a result of such ownership. See § 1.1503(d)-7(c) *Example 13*.

(ii) *Combined separate unit.* This paragraph applies to a dual consolidated loss attributable to a combined separate unit that includes an individual separate unit to which paragraph (c)(4)(i) of this section would apply, but for the application of the separate unit combination rule provided under § 1.1503(d)-1(b)(4)(ii). In such a case, paragraph (c)(4)(i) of this section shall apply to the portion of the dual consolidated loss of such combined separate unit that is attributable, as provided under § 1.1503(d)-5(c) through (e), to the individual separate unit (otherwise described in paragraph (c)(4)(i) of this section) that is a component of the combined separate unit. See § 1.1503(d)-7(c) *Example 14*.

(iii) *Reduction in interest.* The exception under paragraph (c)(4)(i) of this section shall not apply if, at any time following the year in which the dual consolidated loss is incurred, there is more than a *de minimis* reduction in the domestic owner's percentage interest in the partnership or grantor trust, as applicable, as described in paragraph (c)(5) of this section. In such a case, a foreign use shall be deemed to occur at the time the reduction in interest exceeds the *de minimis* amount. See § 1.1503(d)-7(c) *Example 13*.

(5) *De minimis reduction of an interest in a separate unit—(i) General rule.* This paragraph applies to a *de minimis* reduction of a domestic owner's interest in a separate unit (including an interest described in paragraph (c)(4)(i) of this section). Except to the extent provided in paragraph (c)(5)(ii) of this section, no foreign use shall be considered to occur with respect to a dual consolidated loss as a result of an item of deduction or loss composing such dual consolidated loss being made available solely as a result of a reduction in the domestic owner's interest in the separate unit, as provided under paragraph (c)(5)(iii) of this section. See § 1.1503(d)-7(c) *Example 5*.

(ii) *Limitations.* The exception provided in paragraph (c)(5)(i) of this section shall not apply if—

(A) During any 12-month period the domestic owner's percentage interest in the separate unit is reduced by 10 percent or more, as determined by reference to the domestic owner's interest at the beginning of the 12-month period; or

(B) At any time the domestic owner's percentage interest in the separate unit is reduced by 30 percent or more, as determined by reference to the domestic owner's interest at the end of the taxable year in which the dual consolidated loss was incurred.

(iii) *Reduction in interest.* The following rules apply for purposes of paragraphs (c)(4) and (5) of this section. A reduction of a domestic owner's interest in a separate unit shall include a reduction resulting from another person acquiring through sale, exchange, contribution, or other means, an interest in the foreign branch or hybrid entity, as applicable. A reduction may occur either directly or indirectly, including through an interest in a partnership, a disregarded entity, or a grantor trust through which a separate unit is carried on or owned. In the case of an interest in a hybrid entity partnership or a separate unit all or a portion of which is carried on or owned through a partnership, an interest in such separate unit (or portion of such separate unit) is determined by reference to the owner's interest in the profits or the capital in the separate unit. In the case of an interest in a hybrid entity grantor trust or a separate unit all or a portion of which is carried on or owned through a grantor trust, an interest in such separate unit (or portion of such separate unit) is determined by reference to the domestic owner's share of the assets and liabilities of the separate unit.

(iv) *Examples and coordination with exceptions to other triggering events.* See § 1.1503(d)-7(c) *Examples 5, 13, and 14.* See also § 1.1503(d)-6(f)(3) and (f)(5) for rules that coordinate the de minimis exception to foreign use with exceptions to other triggering events described in § 1.1503(d)-6(e)(1), and provide an exception to foreign use following certain compulsory transfers.

(6) *Certain asset basis carryovers.* No foreign use shall be considered to occur with respect to a dual consolidated loss solely as a result of items of deduction or loss composing such dual consolidated loss being made available as a result of the transfer of assets of a dual resident corporation or separate unit, provided—

(i) Such items of loss and deduction are made available solely as a result of the basis of the transferred assets being determined, under foreign law, in whole or in part by reference to the basis of the assets in the hands of the dual resident corporation or separate unit;

(ii) The aggregate adjusted basis, as determined under U.S. tax principles, of all the assets so transferred during any 12-month period is less than 10 percent of the aggregate adjusted basis, as determined under U.S. tax principles, of all the dual resident corporation's or separate unit's assets, determined by reference to the assets held at the beginning of such 12-month period; and

(iii) The aggregate adjusted basis, as determined under U.S. tax principles, of all the assets so transferred at any time is less than 30 percent of the aggregate adjusted basis, as determined under U.S. tax principles, of all the dual resident corporation's or separate unit's assets, determined by reference to the assets held at the end of the taxable year in which the dual consolidated loss was generated. See § 1.1503(d)-7(c) *Example 15.*

(7) *Assumption of certain liabilities—(i) In general.* Except to the extent provided in paragraph (c)(7)(ii) of this section, no foreign use shall be considered to occur with respect to any dual consolidated loss solely as a result of an item of deduction or loss composing such dual consolidated loss being made available following the assumption of liabilities of a dual resident corporation or separate unit, provided such availability arises solely as the result of an item of deduction or loss incurred with respect to, or as a result of, such liabilities. See § 1.1503(d)-7(c) *Example 16.*

(ii) *Ordinary course limitation.* Paragraph (c)(7)(i) of this section shall apply only to the extent the liabilities assumed were incurred in the ordinary

course of the dual resident corporation's, or separate unit's, trade or business. For purposes of this paragraph, liabilities incurred in the ordinary course of a trade or business shall include debt incurred to finance the trade or business of the dual resident corporation or separate unit.

(8) *Multiple-party events.* This paragraph applies to a transaction that qualifies for the triggering event exception described in § 1.1503(d)-6(f)(2)(i)(B) where the acquiring unaffiliated domestic corporation or consolidated group owns, directly or indirectly, more than 90 percent, but less than 100 percent, of the transferred assets or interests immediately after the transaction. In such a case, no foreign use shall be considered to occur with respect to a dual consolidated loss of the dual resident corporation or separate unit whose assets or interests were acquired, solely as a result of the less than 10 percent direct or indirect ownership of the acquired assets or interests by persons other than the acquiring unaffiliated domestic corporation or consolidated group, as applicable, immediately after the transaction. See § 1.1503(d)-7(c) *Example 37*.

(9) *Additional guidance.* The Commissioner may provide, by guidance published in the Internal Revenue Bulletin, that certain events or transactions do or do not result in a foreign use. Such guidance may also modify the triggering events and rebuttals described in § 1.1503(d)-6(e), and the exceptions thereto under § 1.1503(d)-6(f), as appropriate.

(d) *Ordering rules for determining the foreign use of losses.* If the laws of a foreign country provide for the foreign use of losses of a dual resident corporation or a separate unit, but do not provide applicable rules for determining the order in which such losses are used in a taxable year, the following rules shall apply:

(1) Any net loss, or net income, that the dual resident corporation or separate unit has in a taxable year shall first be used to offset net income, or loss, recognized by its affiliates in the same taxable year before any carry over of its losses is considered to be used to offset any income from the taxable year.

(2) If under the laws of the foreign country the dual resident corporation or separate unit has losses from different taxable years, it shall be deemed to use first the losses which would not constitute a triggering event that would result in the recapture of a dual consolidated loss pursuant to § 1.1503(d)-6(h). Thereafter, it shall be deemed to use first the losses from the most recent taxable year from which a loss may be carried forward or back for foreign law purposes.

(3) Where different losses or deductions (for example, capital losses and ordinary losses) of a dual resident corporation or separate unit incurred in the same taxable year are available for foreign use, the different losses shall be deemed to be used on a pro rata basis. See § 1.1503(d)-7(c) *Example 12*.

(e) *Mirror legislation rule*—(1) *In general.* Except as provided in paragraph (e)(2) of this section and § 1.1503(d)-6(b) (relating to agreements entered into between the United States and a foreign country), a foreign use shall be deemed to occur if the income tax laws of a foreign country would deny any opportunity for the foreign use of the dual consolidated loss in the year in which the dual consolidated loss is incurred (mirror legislation), determined by assuming that such foreign country had recognized the dual consolidated loss in such year, for any of the following reasons:

(i) The dual resident corporation or separate unit that incurred the loss is subject to income taxation by another country (for example, the United States) on its worldwide income or on a residence basis.

(ii) The loss may be available to offset income (other than income of the dual resident corporation or separate unit) under the laws of another country (for example, the United States).

(iii) The deductibility of any portion of a deduction or loss taken into account in computing the dual consolidated loss depends on whether such amount is deductible under the laws of another country (for example, the United States). See § 1.1503(d)-7(c) *Examples 17 through 19*.

(2) *Stand-alone exception*—(i) *In general.* This paragraph (e)(2) applies if, in the absence of the mirror legislation

described in paragraph (e)(1) of this section, no item of deduction or loss composing the dual consolidated loss of such dual resident corporation or separate unit would otherwise be available for a foreign use in the taxable year in which such dual consolidated loss is incurred. This determination is made without regard to whether such availability is limited by election (or other similar procedure). However, for purposes of this paragraph (e)(2)(i), no item of deduction or loss composing the dual consolidated loss of a dual resident corporation or separate unit is considered to be made available for foreign use solely because the laws of a foreign country would enable a foreign use through a sale, merger, or similar transaction (provided no such sale, merger, or similar transaction actually occurs). In such a case, no foreign use shall be considered to occur pursuant to paragraph (e)(1) of this section with respect to the dual consolidated loss, provided the requirements of paragraph (e)(2)(ii) of this section are satisfied. See § 1.1503(d)-7(c) *Examples 17 through 19*.

(ii) *Stand-alone domestic use agreement.* In order to qualify for the exception under paragraph (e)(2)(i) of this section, the consolidated group, unaffiliated dual resident corporation, or unaffiliated domestic owner, as the case may be, must enter into a domestic use agreement in accordance with the provisions of § 1.1503(d)-6(d) and, in addition, must include the following items in such domestic use agreement:

(A) A statement that the document is also being submitted under the provisions of paragraph (e)(2) of this section.

(B) A certification that the conditions of paragraph (e)(2)(i) of this section are satisfied during the taxable year in which the dual consolidated loss is incurred.

(C) An agreement to include with each annual certification required under § 1.1503(d)-6(g), a certification that the conditions described in paragraph (e)(2)(i) of this section are satisfied during the taxable year of each such certification.

(iii) *Termination of stand-alone domestic use agreement.* This paragraph (e)(2)(iii) applies to a consolidated group, unaffiliated dual resident cor-

poration, or unaffiliated domestic owner, as the case may be, that entered into a domestic use agreement pursuant to paragraph (e)(2)(ii) of this section, with respect to a dual consolidated loss, and which subsequently makes an election pursuant to § 1.1503(d)-6(b) (relating to agreements entered into between the United States and a foreign country) with respect to such dual consolidated loss. In such a case, the dual consolidated loss shall be subject to the election under § 1.1503(d)-6(b) (and any related agreements, representations and conditions), and the domestic use agreement entered into pursuant to paragraph (e)(2)(ii) of this section shall terminate and have no further effect.

[T.D. 9315, 72 FR 12914, Mar. 19, 2007]

§ 1.1503(d)-4 Domestic use limitation and related operating rules.

(a) *Scope.* This section prescribes rules that apply when the general limitation on the domestic use of a dual consolidated loss under paragraph (b) of this section applies. Thus, the rules of this section do not apply when an exception to the domestic use limitation applies (for example, as a result of a domestic use election under § 1.1503(d)-6(d)). In general, when the domestic use limitation applies, the dual consolidated loss of a dual resident corporation or separate unit is subject to the separate return limitation year (SRLY) provisions of § 1.1502-21(c), as modified under this section. Paragraph (c) of this section provides rules that determine the effect of a dual consolidated loss on a consolidated group, an unaffiliated dual resident corporation, or an unaffiliated domestic owner. Paragraph (d) of this section provides rules that eliminate dual consolidated losses following certain transactions or events. Paragraph (e) of this section contains provisions that prevent dual consolidated losses from offsetting tainted income. Finally, paragraph (f) of this section provides rules for computing foreign tax credits.

(b) *Limitation on domestic use of a dual consolidated loss.* Except as provided in § 1.1503(d)-6, the domestic use of a dual consolidated loss is not permitted. See